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The International Securities Lending Association (ISLA) response to the FSB Consultative Report: Possible Measures of Non-Cash collateral re-use

On behalf of our members, ISLA would like to thank you for the opportunity to comment on the above consultation paper.

Our members note that a precise measurement of collateral re-use would be very difficult to achieve because many financial institutions manage collateral using pools of fungible securities for efficiency and to reduce overall settlement risk. These pools will hold collateral received as a result of other transactions and firms' own assets. The fungible nature of the securities makes it impossible to distinguish whether a particular security is collateral or own assets.

Financial institutions will have multiple sources and uses of securities and this means that assets will be received in and out of an account with multiple transactions in a security issue each day. Whilst firms will identify the aggregate positions and collateral liabilities within a security, it would be impossible to identify the source of securities used for any individual transaction.

It should also be noted that agent lenders and beneficial owners who lend securities and receive non-cash collateral are very unlikely to re-use the collateral and most commonly hold the securities in a segregated collateral account. ISLA analysis suggests that approximately 60% of securities loans are collateralised with non-cash collateral and that the majority of this is held in tri-party collateral accounts where re-use is not practicable.[1] Where no collateral is re-used it may be more appropriate for a firm to provide a "nil return" rather than have to develop systems and reporting templates, as well as develop a calculation process.

ISLA would also like to highlight the work that ESMA are undertaking as part of developing the Securities Finance Transaction Regulation which includes proposals for collateral re-use measurement. From a market respective a consistent approach to methodology across markets is helpful in achieving efficiency and accuracy on reporting. To any extent possible, ISLA would like to recommend that FSB and ESMA methodology is fully aligned.

In analysing the three options proposed for collateral re-use, members expressed views that Options 1 (exact measure) and 2 (the approximate measure) would both provide a reasonable approximation of collateral re-use and would be preferred over Option 3 (indirect approximation). Option 3 is an inappropriate measure of collateral re-use as it is based on the flawed assumption that firms use collateral received first, only using own assets when the

[1] The ISLA market report, which provides the detailed analysis can be found at www.ISLA.co.uk

collateral received is insufficient. This assumption is an inaccurate starting position as many firms' asset allocation methodologies in fact, give priority to the firm's own assets. By beginning with an incorrect assumption, members are concerned that any measurement could be significantly distorted. The FSB noted in its commentary that option 3 will generally overstate the amount of collateral being re-used. As none of our members suggested their firm's asset allocation methodologies operated on a collateral first basis, it seems likely that the overstatement of collateral re-use determined using Option 3 would be significant.

In response to specific questions

***Q1**. Does the proposed scope of transactions for data collection (Scope A) provide a practical basis for the meaningful measure of non-cash collateral re-use? If not, please explain how you think the scope should be broadened and the reasons why this alternative scope is more appropriate than the proposed scope.*

ISLA notes that the definition provided for re-use is broader than the definition used in the publication of its recommendations in August 2013, which the market found helpful in defining re-use and re-hypothecation as different and separate activities. We also note that the definition of re-use provided here is different again to the EU definition adopted in the SFT Regulation.

In order to achieve any level of global data aggregation there needs to be a consistent definition of the applicable elements that represent re-use and re-hypothecation.

In considering the two options for the scope of transactions, we note that option A restricts measurement to "collateral posted or received and subsequently used as collateral in another SFT" which reverts to a definition closer to that provided in August 2013. We interpret this to limit collateral received to collateral received in respect of an SFT i.e. collateral received as collateral in an OTC derivative transaction and subsequently posted as collateral in an SFT would not be included in this measure of re-use.

We believe it is reasonable to use collateral received and re-used within SFTs as a proxy for collateral re-use in the markets more generally. As defined, SFTs will represent the majority of collateral re-use and introducing other types of transaction as contemplated in option B will add complexity unnecessarily.

***Q2**. Are there any practical issues (e.g. updating current business practices, IT systems) in relation to the three measures of collateral re-use that are set out in this Section? Are there any ways to improve these measures?*

Most large firms will track sources and uses of assets (on an aggregated basis) although this may be in different systems than those used for reporting purposes. This means that there will be a requirement to develop systems and processes in order to aggregate and report the data required and so ISLA welcomes the FSB recognition that these factors should be taken into consideration when developing its recommendations.

***Q3**. For the first measure, are there any practical issues in reporting whether collateral you posted is in the form of "own assets" or in the form of assets that were received as collateral in a previous transaction?*

As previously stated, most firms may be able to identify aggregated sources and uses of assets. However when collateral is received under a title transfer collateral arrangement (which is the method of transfer under the GMSLA and other industry master agreements commonly used in Europe for SFTs), there is no legal or practical distinction between own assets and collateral assets. Both belong to the firm and are likely to be held in a single firm depot. Due to the fungiblity of the securities in the account, it is not currently possible to link specific securities to any particular source or transaction.

***Q4**. Are there other measures of collateral re-use that the FSB should consider for financial stability purposes?*

No other measures were identified during discussions with member firms.

***Q5**. Do you have views on any of the six metrics related to collateral re-use that are set out in this Section? If so, please indicate the metric(s) and explain the views you have*

4.3 Re-use Reliance Rate

Referring to this as a reliance rate is a misnomer as firms may re-use collateral as a matter of efficiency, but this does not mean they are reliant on collateral received to meet their obligations.

This metric assumes that all sources of assets are known, including sources unrelated to SFTs when a firm selects which assets to use in meeting their obligations. Given the nature of the estimates and the different limitations of the proposed calculations this may not always be known and thus the reliance result could ultimately be misleading.

4.5 Collateral circulation length.

ISLA members are concerned about this metric as they do not believe that the measurement will be accurate given the aggregated and fungible nature of securities.

A firm may receive a security as collateral under a title transfer collateral arrangement and, at the same time deliver the same security as collateral however due to the fungible nature of the securities it is not possible to link the transactions in any meaningful manner as the security posted as collateral may represent "own assets" or collateral. Assets held in a collateral pool cannot be distinguished in this manner. Making an assumption about the linking of the two transactions in this way will lead to an overstating the levels of interconnectedness in the collateral market.

Furthermore, it should be recognised that because the calculation is based on the re-use calculation, which in itself is an estimate, the results of this calculation will be an estimate based on an estimate and so may lead to unrepresentative results.

***Q6**. Are there any other metrics related to collateral re-use that the FSB should consider for financial stability purposes? If so, please define the metric(s) and explain how the metric could be used for financial stability purposes*

No further metrics were identified by our members.

***Q7**. In your view, are the data elements set out …appropriate for calculating the collateral re-use measures in Section 3? Are there alternative data elements that the FSB should consider? If so, please explain the data elements and the reasons.*

ISLA believe that the data elements in table 1 are appropriate for the proposed measurements. However, it should be noted that the data element requirements will depend on the choice of the proposed calculation and thus they may not all be required.

***Q8**. Are there any practical issues on the data elements for calculating the collateral re-use measures that are set out?*

As previously mentioned, the larger firms will already have information relating to aggregated sources and uses of assets which allow option 1 or 2 to be implemented, however the development of processes and system enhancements will be required in order to implement aggregation of data and reporting being proposed.

To ensure a consistent approach in the development of calculation methodology and data aggregation, the FSB should provide additional clarification in relation to actual data that should be included in these data element definitions.

***Q9**. In your view, should the collateral types for measuring collateral re-use align with those set out in the November 2015 global securities financing data standards as set out in Table 1? If not, please explain which collateral types you think are appropriate for the collateral re-use measure(s).*

ISLA believes that the collateral types in table 1 are appropriate and should not be further amended from those set out in November 2015.

***Q10**. Are there any views on the data architecture issues related to measuring collateral re-use as set out in this Section? Do you see any statistical issues arising as a result of the proposed aggregation approach?*

ISLA members have not expressed any specific views on the data architecture issues.

***Q11**. Are there any other views on other aspects of this document?*

Our members have no further views or comments at this stage.

We hope that you find these comments helpful and welcome any opportunity to discuss them in further detail.

Yours sincerely,

Kevin McNulty

Chief Executive

The International Securities Lending Association (ISLA) is a trade association established in 1989 to represent the common interests of participants in the securities lending industry. It has approximately 100 full and associate members comprising insurance companies, pension funds, asset managers, banks, securities dealers and service providers representing more than 4,000 clients. While based in London, ISLA represents members from more than sixteen countries in Europe, and the rest of the world. For more information please visit the ISLA website